TD 2004/60 - Income tax: consolidation tax cost setting rules: step 4 of the allocable cost amount: should tax losses or net capital losses transferred to a joining entity be taken into account when determining whether there will be a subtraction at subparagraph 705-95(b)(ii) of the Income Tax Assessment Act 1997 ?

Taxation Determination

Income tax: consolidation tax cost setting rules: step 4 of the allocable cost amount: should tax losses or net capital losses transferred to a joining entity be taken into account when determining whether there will be a subtraction at subparagraph 705-95(b)(ii) of the *Income Tax Assessment Act 1997*?

Preamble

The number, subject heading, date of effect and paragraph 1 of this document are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner.*

1. No. Losses transferred to a joining entity (income company) by another member of a wholly-owned group (loss company) prior to the joining entity becoming a member of a consolidated group are not treated as losses of the joining entity accruing to the group for the purposes of subparagraph 705-95(b)(ii) of the *Income Tax Assessment Act 1997* (ITAA 1997). Instead, adjustments may be made at step 1 and/or step 2 of the allocable cost amount (ACA) for the loss company if it also joins the consolidated group (see subsection 705-65(3) and 705-75(3) respectively). Adjustments may also be made at step 1 and/or step 2 for the income company (see paragraph 5.60, 5.72 and Table 5.2 of the Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002.

Example

2. On 30 June 2001 Alpha Co is incorporated as a wholly-owned subsidiary of HCo, with an initial capitalisation of $100,000 (100 shares at $1,000 each). On the same day, Beta Co is incorporated as a wholly-owned subsidiary of HCo for $100,000. For the year ended 30 June 2002 Alpha Co made a tax loss of $20,000. In the year ended 30 June 2002 Beta Co had assessable income of $20,000 (net of deductions). Alpha Co transferred the tax loss to Beta Co under Subdivision 170-C of the ITAA 1997. Beta Co made a subvention payment in respect of the loss transfer to Alpha Co of $6,000. Accordingly, Alpha Co's net accounting and economic loss was $14,000 net of the subvention payment. As a result, Beta Co's taxable income was $nil. Beta Co distributed its profit to HCo on 30 June 2002. HCo elects to form a consolidated group, effective 1 July 2002. The market value of Alpha Co and Beta Co are $86,000 and $100,000 respectively.

3. Alpha Co's financial position at 1 July 2002 is shown in Table 1.

Table 1: Alpha Co – Financial Position at 1 July 2002 ($)

Cash	86,000	Equity	100,000
		Retained earnings (loss)	(14,000)
	86,000		86,000

4. Beta Co's financial position at 1 July 2002 is shown in Table 2.

Table 2: Beta Co – Financial Position at 1 July 2002 ($)

Cash	100,000	Equity	100,000
		Retained earnings (loss)	(0)
	100,000		100,000

5. Alpha Co's ACA would be as follows:

Table 3: ACA calculation for Alpha Co

Step 1	Add cost of membership interests: • subsection 705-65(1): compare the cost base & reduced cost base (adjusted as appropriate under subsection 705-65(3)) and market value: • Cost base *less* (loss transferred minus subvention payment): 86,000 [100,000 – (20,000 - 6,000)] • Reduced cost base *less* (loss transferred minus subvention payment): 86,000 [100,000 – (20,000 - 6,000)] • Market value: 86,000	86,000	86,000
Step 8	ACA		86,000

6. When determining the step 1 amount under subsection 705-65(1), certain adjustments are required [under subsections 705-65(3), (4) and (5)] to the cost base (CB) and reduced cost base (RCB) of membership interests. The step 1 amount of the CB or RCB is reduced for adjustments that would have occurred under Subdivision 170-C had the membership interests been disposed of just prior to the joining time under subsection 705-65(3). The CB and RCB are reduced by the amount of the economic loss, net of the subvention payment.

7. Once the relevant adjustments are made to the CB and RCB of each membership interest, they are then compared against the market value of the relevant membership interest at the joining time. The final step 1 amount is the sum of the following amounts for each membership interest. If the market value is:

- equal to or greater than its CB = use its CB;
- less than CB but greater than RCB = use its market value; or
- less than or equal to RCB = use RCB.

In Table 3, the CB, RCB and market value for each share are equal and the shares have been grouped for convenience.

8. Beta Co's ACA would be as follows:

Table 4: ACA calculation for Beta Co ($)

Step 1	Add cost of membership interests:		
	Subsection 705-65(1) compare the cost base & reduced cost base [adjusted as appropriate under subsection 705-65(3)] and market value:		
	• cost base plus increase in market value: 100,000 (100,000 + 0)		
	• reduced cost base plus increase in market value: 100,000 (100,000 + 0)		
	• market value: 100,000	100,000	100,000
Step 4	Less Pre-joining time distributions out of certain profits		(0)
Step 8	ACA		100,000

9. The CB and RCB used in working out the step 1 amount under subsection 705-65(1) are increased under subsection 705-65(3) to the extent the market value of each membership interest increased as a result of the loss transfer. These are the adjustments that would have occurred under Subdivision 170-C had the membership interests been disposed of just prior to the joining time. In this case there was no increase in market value of Beta Co's membership interests as a result of the loss transfer because of the subvention payment made [see subsection 170-215(4)]. As the market value of each membership interest is the same as both the CB and RCB, the step 1 amount totals $100,000 as shown in Table 4.

10. No amount is subtracted at step 4 as transferred losses are not treated as losses for the purposes of subparagraph 705-95(b)(ii).

11. The tax cost setting amount for the retained cost base asset (that is, cash) is $100,000. There is no shortfall or excess ACA.

Date of effect

12. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation
27 October 2004

Previous draft:

TD 2004/D37

Related Rulings/Determinations:

TR 92/20

Subject references:

- ACA
- allocable cost amount
- consolidation
- cost base
- cost setting
- deferred tax assets
- income company
- loss company
- losses
- losses transferred
- market value
- profits
- reduced cost base
- retained earnings
- step 1
- step 2
- step 4
- tax losses
- wholly-owned subsidiary

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 Subdiv 170-C
- ITAA 1997 170-215(4)
- ITAA 1997 705-65(1)
- ITAA 1997 705-65(3)
- ITAA 1997 705-65(4)
- ITAA 1997 705-65(5)
- ITAA 1997 705-75(3)
- ITAA 1997 705-95(b)(ii)

Other references:

- Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002

ATO references
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